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Why it pays to buy funds through a discount broker. (mutual funds)(includes related articles) (1995 Financial Planning Guide)

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TEXT:

By opening a single brokerage account, you can switch your among dozens of funds--without a charge. There are other pluses, too.

Discount brokers who made their names by shaving commissions have found a new way to attract business: They're making life simpler for investors who buy no-load mutual funds.

By opening a single brokerage account, you can buy funds from dozens of fund companies. That avoids the hassles of contacting each company directly and cuts down on paperwork all year long, but especially at tax time.

To appreciate the advantages of the discounters' fund accounts, consider what you face if you're an old-fashioned type who deals directly with funds. Say you've got $10,000 in Twentieth Century Ultra Investors, an aggressive fund, and you decide to switch to the tamer Founders Blue Chip Fund. A week or more might pass before you receive your redemption check from Twentieth Century and can buy your Founders Blue Chip shares. Meanwhile, your money would languish in investment limbo, earning nothing.

Now suppose you wise up and hold your funds in an account with a discount broker. To switch your money from Twentieth Century to Founders, you call the discounter. Within a day, the deal's done.

A handful of discounters perform this speedy service. They include Charles Schwab & Co., Fidelity Investments, Jack White & Co., Muriel Siebert & Co., and Waterhouse Securities.

Sounds great, you say. But what does it cost? Nothing. Instead of charging investors, the discounters take fees from the fund companies.

"So far, most funds haven't passed the buck back to investors by raising their annual expense charges," says William J. Mikus, a Hermosa Beach, Calif., investment adviser who uses Schwab's plan for his clients' accounts.

The free programs do come with some limitations. To hold down costs, discounters impose restrictions on frequent traders. Most limit the number of free trades you can make within a 12-month period. Some also require you to hold a fund for six or nine months before selling. Break the rules and you'll face a charge--in some cases on all future trades. And though you can transfer funds you already own into your discount brokerage account, you'll likely pay a transaction fee when you sell those shares if the funds aren't in the discounter's no-fee program.

Don't be surprised if a discounter doesn't include your favorite fund in its no-transaction-fee program. The biggest offer only about 400 funds. That gives you enough choices to build a diversified portfolio, but thousands of funds remain outside the fold. Holdouts include such popular fund families as T. Rowe Price and Vanguard.

If your discounter's no-fee program doesn't include the fund you want, check for look-alike funds. You can also inquire about paying a fee to buy your favorite fund. Besides the selections in their no-fee programs, brokers carry hundreds of other funds that they sell for fees of at least $27 for each transaction. Paying a charge may be worthwhile, since it enables you to consolidate your holdings in a single account.

Help at tax time

If you feel buried under mounds of fund statements, a discount account could be your salvation. With just one monthly statement, the discounter covers all your funds. The investor who buys funds directly from a dozen

companies gets statements from all of them.

Discounters' simplified paperwork can be particularly welcome at tax time. Instead of separate copies of Form 1099-DIV from each fund or fund family, you get one form that summarizes tax data for all your holdings. Most discounters also list the average cost basis of any shares you've sold. That eliminates the shareholder nightmare of shuffling through years of back records trying to calculate capital gains taxes.

Discounters also make it easy to book tax losses. Say your shares of Dreyfus Intermediate Municipal Bond Fund took a beating when interest rates rose earlier this year. instead of just sitting glumly, phone your broker and sell the fund. Now you can take the loss. You can use it to offset capital gains if you have them, or up to $3,000 of this year's ordinary income. You can hold over the excess above $3,000 for future use.

When you sell that Dreyfus fund to take the loss, invest the proceeds in a similar fund, such as Neuberger & Berman Municipal Securities Trust. That way, you'll keep a municipal investment in your portfolio while avoiding problems with the IRS "wash sale" rule that prevents claiming a loss if you buy the same security within 30 days of selling it. You can wait the prescribed period and then decide whether to keep the Neuberger Berman fund or switch back to Dreyfus.

IRA investing made easier

Discounters' fund accounts can work with trusts, 401(k)s, and other pension plans. But they're especially appealing for Individual Retirement Accounts.

While many fund families charge annual IRA fees of $10 or more, some discounters waive the fee when your investment exceeds a minimum amount. At Schwab and Jack White, the minimum is $10,000; Fidelity requires only $5,000. Fidelity also drops loads that can range up to 3 percent on many funds held in an IRA.

Besides saving you a few bucks on fees, such a fund account can help you sidestep a nasty trap the tax man has laid for unwary IRA owners. The trap can spring anytime you pull money out of an IRA. Consider Dr. Green, who wants to switch $10,000 of his IRA money from Strong Advantage Fund to Janus Fund. Green--who deals directly with his funds--instructs Strong to sell shares and mail him the proceeds. When he opens the envelope, he's startled to find a check for $8,000. Under the law, Strong must withhold 20 percent of early IRA withdrawals to cover income taxes and penalties.

To prevent the Feds from keeping his $2,000, Green must roll the full $10,000 he withdrew into his new IRA at Janus within 60 days. To meet that deadline, he takes $2,000 from his savings to replace what Strong withheld. He'll get the withheld money back--but not until he has filed his tax return next April.

Green could avoid this whole hassle by signing a form giving Strong permission to liquidate his shares and transfer the proceeds directly to Janus. But a direct transfer takes days at the least, sometimes weeks.

Better yet, he could make the switch through an account at a discounter. That way, no money would be withheld. And the transfer would be completed in a day, keeping his money fully invested.

24-hour trading

Discounters offer another perk you won't get from most funds: 24-hour service. If you feel the need to learn your balance or make a trade at 3 a.m., the brokers will oblige. Some have phone representatives standing by around the clock. Others permit trading with a touch-tone phone or computer.

Fidelity and Schwab cut their fees 10 percent for any transactions placed by computer, Muriel Siebert offers the same discount for both computer and automated phone orders.

By making fund trading easier, the discounters have broken new ground. Many investors may find they can do all their stock and fund trading with only one account. Even if you prefer dealing with a full-service broker who provides you with advice, you might want to put some of your money in a discount account.

Dealing with a discounter can simplify your financial life.

How a discount broker simplified one doctor's life

When Gary J. Chang, an anesthesiologist from Rolling Hills, Calif.,

was a neophyte investor in his 30s, he turned to full-service brokers for advice. But he was continually disappointed.

"They seemed to recommend investments that would generate big commissions, not necessarily the ones that were best for me," says Chang. "I rarely got a clear explanation of the risks involved. And I couldn't get a straight answer about how much I was making after commissions were subtracted. I had to run computer programs myself to find that out."

Two years ago, Chang abandoned full-service firms and began working with William Mikus, an investment adviser in Hermosa Beach, Calif. Mikus specializes in purchasing no-load mutual funds through discounter Charles Schwab & Co. Schwab and a few other discounters offer convenient accounts that permit investors to trade no-load funds.

Mikus advised Chang to dump his $300,000 in individual stocks, most of them held in his corporate pension plan. Heavily weighted with biotechnology stocks, the portfolio seemed risky for Chang, who hopes to retire in 20 years. The individual stocks also produced a burdensome amount of paperwork for Chang.

Since Chang seeks growth without extreme risk, Mikus opened a Schwab account and gradually invested the money in a diversified group of small- and large-cap growth funds, international funds, and equity-income funds.

Chang's portfolio currently contains nine funds, including Columbia Growth, Founders Discovery, Dreyfus Wilshire Large Company Growth, Oakmark International, and Warburg Pincus International Equity. Schwab charges a one-time fee of $29 or more to buy some of the funds; others come with no upfront charges.

So far Chang is delighted with the results. "I'm spending far less on commissions and earning 15 to 18 percent a year on my money without taking extraordinary risks. And I no longer have to spend several hours a week logging transactions into my computer to track my investment returns and expenses. I can get the same information in a few minutes from Schwab's monthly statements and Bill's quarterly review."

When a full-service broker can help

If you prefer to call your own investment shots, rather than rely on a mutual-fund manager or a broker to guide you, you may see little reason to use a full-service broker. Why shop at a financial department store when the discounters down the street charge less? But traditional brokers can earn their keep, if you use them selectively. Here are securities you should buy through full-service brokers.

* Foreign stocks. Trading on overseas exchanges can be expensive and cumbersome. But if you decide to venture abroad, you'll need a broker who can handle currency conversions and understands foreign regulations.

The best bets include large brokerages that have staffs abroad, such as Merrill Lynch or PaineWebber, says Steven B. Enright, a financial adviser in River Vale, N.J. With analysts on the site, the big operators can keep abreast of foreign companies and speed the execution of your order.

Such service isn't for small fish, however. Merrill Lynch requires you to invest at least $25,000 each time it buys stocks for you on an overseas exchange.

* Bonds. Full-service firms dominate the bond business. That means they can often provide you with the best selection and prices, says Frederick A. Lynn, an investment adviser in New Canaan, Conn. In a business where amateurs can get fleeced, you'll want a knowledgeable pro on your side. "An experienced broker will haggle to get you a fair price," Lynn says.

Even after you've located a good broker, it sometimes pays to shop around--especially for municipals, whose prices can vary all over the lot. Steve Enright's suggestion: Tell a few brokers from different firms what you want. For instance, you might request Connecticut general obligation bonds with maturities of 10 years and credit quality rated A or higher. Ask each broker to fax you a list of prices. Ask the brokers about the spreads--the difference between the "bid" price the broker pays and the "ask" price you'd pay--to weed out any that are overpriced. Prices can change daily, though, so don't get the quotes until you're prepared to buy.

What if you find the best deal at a firm where you don't hold any

other securities? No problem, says Enright. You can buy the bond from that brokerage and have it transferred to your account elsewhere, so all your investments stay housed in the same place.

* New and over-the-counter stocks. To buy shares in hot new companies, stick with full-service brokers. Discounters rarely get shares of the best initial public offerings, Lynn says. Such shares often are reserved for prized customers of the big firms. Discounters don't get into the game until the shares start to change hands, and by then prices may already have risen.

A full-service firm can also provide critical help when you buy over-the-counter stocks, says Lynn. An aggressive broker can "work" your order--bargaining with other dealers to lower the price. A discount firm may just buy the first available shares.

* Trading a few shares. Here's one category where full-service operators offer the lowest prices. For example, you'd pay $20 or more to buy or sell one share of a $25 stock through a discounter. But at Merrill Lynch you'd pay as little as $6.25 for that service. Since full-service brokers don't necessarily advertise their best prices, you'll need to ask to get special deals.

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